A Growing Field of Opportunity.

HILLSBOROUGH
Resources Limited
ANNUAL REPORT 2002

HILLSBOROUGH RESOURCES LIMITED
Annual Report 2002: Table of Contents

HILLSBOROUGH RESOURCES LIMITED is a Canadian based coal mining company traded on the Toronto Stock Exchange.

Its principal asset is the wholly owned Quinsam Coal mine located near Campbell River on Vancouver Island.

Quinsam produces a very high quality thermal coal much sought after by power plants and other industrial applications.

Your company believes that shareholder value is best created through the successful execution of a sound growth strategy.

There are four key foundations to Hillsborough's growth strategy, namely:

- **Expanding the Core Business**—This entails working closely with new industrial customers to get approval for use of Quinsam's coal in their application and developing new markets. Quinsam's recent sales to the greenhouse and pulp and paper industries are examples of the success of this strategy.
- **Developing our coal bed methane potential**—The company is working closely with the government of British Columbia to resolve outstanding title conflicts surrounding the potential coal bed methane contained in its freehold coal resource. We believe a resolution to this conflict is near. Additionally, Hillsborough recently entered into a joint venture to pursue the exploration of the methane potential in its coal resources.
- **Power Project**—Hillsborough has undertaken engineering and permitting studies to determine the feasibility of building a coal fired power plant at the Quinsam Mine. The findings from this work were very encouraging. The next step is to acquire a power sales contract with BC Hydro, the local power distributor on Vancouver Island. Progress on this front has been slow.
- **Industrial Minerals**—Hillsborough is currently exploring a deposit to possibly develop a mine to produce an industrial mineral that its customers badly need and is also used by Quinsam in the production of its coal.

In Port Alberni, Ivor & Pat Rage also burn Quinsam coal, providing cheap, efficient heat for their crop of cucumbers.

Ivor, a former head of the BC Hothouse Association, was GH Fuels' first customer. We admire him and Max for their innovation and courage in taking on the skeptics and showing them that coal is an excellent fuel for the greenhouse industry.

THE SIGNIFICANT ACCOMPLISHMENTS for your Company in 2002 include:

- The sale of refurbished equipment and related parts to a South American coal mine realized profits of $533,399.
- Quinsam Coal Corporation was, for the fourth consecutive year, the winner of the B.C. Small Underground Mine Safety Award. A notable achievement for its consistency.
- Hillsborough finalized a joint venture agreement for the exploration of the coal bed methane (CBM) on its freehold property and made significant progress in resolving the title conflicts with the government.
- Quinsam commenced commercial coal sales into the pulp and paper market.
- Hillsborough repaid 100% of the outstanding long term debt and generated free cash of $1.3 million.

THE GREENHOUSE INDUSTRY

Max and Karen Grober own and operate a highly successful greenhouse near Campbell River on Vancouver Island. They grow high quality peppers, reds, greens, orange and yellows, much in demand by local supermarkets.

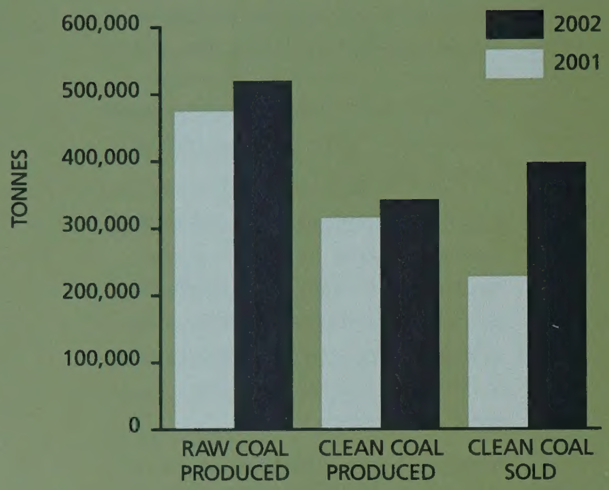
Like most greenhouses, the Grobers' used natural gas to fuel the water heaters which keep the greenhouse at a steady 23 degrees Celcius. The substantial spike in natural gas prices in 2001 resulted in the Grobers switching to coal.

More and more greenhouses are considering a change to coal from gas, although the high capital cost of a new combustor can be a deterring factor. Modern burners can burn coal cleanly and efficiently, at a price less than a third that of natural gas.

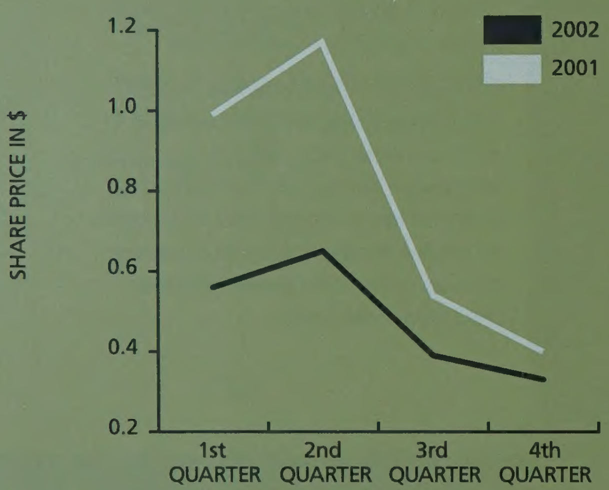
GH Fuels Inc. was formed to target this growing market. Thus far most of its business is confined to Vancouver Island, but terminals have been set up in Langley and Richmond to service the large growth expected to soon come from greenhouses on the Lower Mainland.

"We would have been bankrupt were it not for coal," says Max, a hard-working, genial, former logger. "Quinsam saved our bacon, and has put us into a position where we are seriously considering doubling the size of our operation. We couldn't do it without coal."

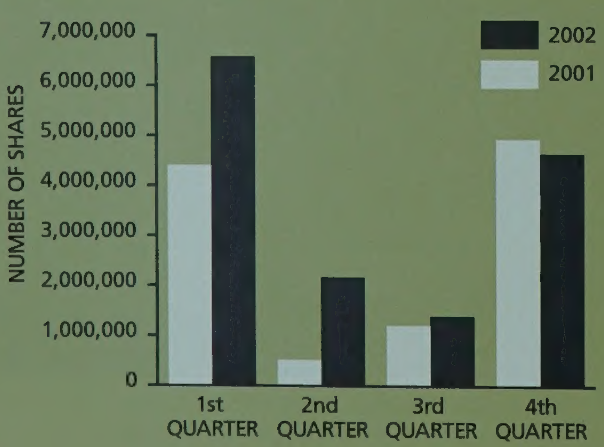
KEY OPERATING STATISTICS



SHARE PRICE INFORMATION



SHARE VOLUME INFORMATION



SELECTED FINANCIAL INFORMATION

(000's Cdn Dlrs)	2001 (restated)	2002
Coal sales		
1st quarter	2,973.1	4,973.8
2nd quarter	3,191.8	5,901.1
3rd quarter	2,455.4	3,028.9
4th quarter	2,039.0	4,083.4
Income from Coal Operations		
1st quarter	614.0	398.4
2nd quarter	833.5	583.5
3rd quarter	713.6	529.8
4th quarter	598.4	822.1
Net Income (Loss)		
1st quarter	224.8	-22.2
2nd quarter	-65.7	-119.7
3rd quarter	244.9	523.2
4th quarter	-90.8	-573.7
Cash Flow from Operations		
1st quarter	-1,168.9	1,710.4
2nd quarter	-1,153.7	446.1
3rd quarter	106.9	-592.4
4th quarter	-1,161.0	1,023.5
Total Assets		
1st quarter	12,186.1	17,194.9
2nd quarter	17,331.6	16,818.2
3rd quarter	17,376.4	17,059.3
4th quarter	16,953.4	17,133.1
Shareholders Equity		
1st quarter	4,245.5	13,837.3
2nd quarter	13,871.6	13,717.6
3rd quarter	13,998.5	14,240.9
4th quarter	13,859.5	14,049.9
Working Capital		
1st quarter	170.3	6,279.2
2nd quarter	7,280.3	6,127.1
3rd quarter	6,800.3	6,678.7
4th quarter	6,463.4	5,875.1
LT Debt		
1st quarter	2,570.9	0.0
2nd quarter	144.9	0.0
3rd quarter	91.6	0.0
4th quarter	0.0	0.0

RESERVE AND RESOURCE TABLE
as at December 31, 2002

(million tonnes)	Dec 31 2001	Dec 31 2002
RESERVES		
Proven	14.50	14.70
Probable	6.30	6.60
Subtotal Reserves	20.80	21.30
RESOURCES		
Reserves	20.80	21.30
Measured	4.73	5.40
Indicated	0.97	3.20
TOTAL RESERVES & RESOURCES	**26.50**	**29.90**

Notes:

Reserves were calculated under the direction of Mr. Kresho Galovich. P. Eng a qualified person in accordance with N.I. 43-101

Resources were calculated under the direction of Mr. Stephen Gardner P. Geo a qualified person in accordance with N.I. 43-101

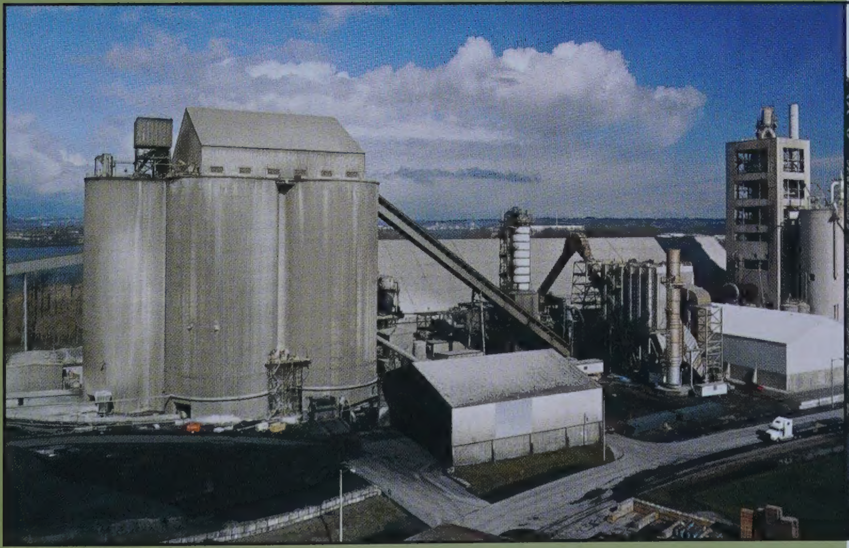
Approximately 8.1 million tonnes of the Total Reserves and Resources are below 1% sulphur.

THE CEMENT INDUSTRY

Quinsam's biggest customer is Lehigh Cement, based in Delta, near Vancouver, British Columbia. Lehigh is an important member of the world-wide Heidelberg group of companies, with headquarters in Germany. As many as four barges of coal wend their way each month to Lehigh's plant on the Fraser River. There the coal is pulverized to a fine powder and compressed air forces the powder into a revolving kiln. The resulting heat provides the energy to convert all of the principal ingredients in the recipe into a high grade cement. Lehigh's cement has been used in many of the office towers in Vancouver, in the construction of the Vancouver Public Library, and in the building of the new runway at the Vancouver International Airport.

Ashgrove Cement in Seattle, Washington is another long-time Quinsam customer. This privately-owned plant has a dominant position in the Puget Sound area, and its products have been used in the construction of both the Seahawks' Stadium as well as the new Safeco Stadium, home to the Seattle Mariners.

Several cement plants in California have been discussing their fuel requirements with Quinsam, and we see this as being an excellent future market for our high quality thermal coal.



"Quinsam has been our primary supplier of coal since 1987" says Ray Romaniuk, Lehigh's Plant Manager at the Tilbury Island facility. "We appreciate the flexibility they have shown in meeting our scheduling needs which require working around our cement shipments and our other raw material deliveries. Quinsam coal handles well, is low in sulphur, and with a high volatile content gives a good flame which is critical to the kiln operation."

My Fellow Shareholders,

This past year was one of disappointing financial results. Never-the-less, there were some significant accomplishments which we believe positioned your company for improved performance in the years to come.

Like many of you, I was disappointed in the performance of the price of our common stock which was impacted by a number of events both outside of and within our control. In 2000 and 2001, the common stock of energy companies enjoyed favour as the United States experienced a number of energy shocks which tended to inflate the cumulative market value of the industry on North American stock exchanges. In 2002, with the continuation of the economic slowdown in the United States and the financial duress of a significant number of global energy companies in North America, the energy industry, as with the rest of the stock market in general, fell into disfavour with the investing public. This lack of interest depressed the market value of our stock. It was unfortunate that the financial markets failed to recognize that your company has none of the financial issues that were problematic with a number of other publicly traded companies in North America.

I am delighted to report that a number of achievements were realized in 2002. These achievements serve to highlight Hillsborough's growing field of opportunity, and they include such things as:

- In November 2002, the new energy policy announced by the Government of British Columbia strongly endorsed the role of Independent Power Producers in this Province. The Government came out in public support of coal fired electricity producers, which we believe, will allow us to pursue the advancement of our power project to be located at the Quinsam Mine. However, we can give no guarantees that our efforts will prove to be successful.

- With our acquisition of D and R Resources Inc., we acquired the rights to some coal resources which we believe are the most logical supply of coal for a near by coal fired power plant. Your company is presently working to permit these resources and to acquire the necessary contracts to supply the power plant with coal. Unfortunately, as I write this letter the future operations of this power plant has become uncertain.

- We successfully refurbished and then sold some mining equipment and related parts realizing a significant financial gain. This equipment was originally acquired at distressed prices from the liquidation of assets of a bankrupt coal company.

- We made our first commercial sale of coal to a local pulp and paper company which we believe is the initial step in developing a new, strategically important market for your company's coal.

- We are actively investigating a number of investment opportunities in the coal mining and related energy fields.

- The Quinsam Mine was awarded the prestigious J.T. Ryan award for its outstanding safety performance in 2001. In 2002, we continued our exemplary safety performance by winning, for the fourth consecutive year, the B.C. Small Underground Mine Safety Award.
- We continue to provide consulting services to a group of South American mining companies.

Mining Operations

During the 2002 fiscal year, we were mining in an area of our coal deposit which presented us with a number of severe operational challenges. The development and mining of this area was necessary to ensure that we maximized the production of our "super compliant" coal reserve base. However, the combination of difficult conditions underground and lower than expected yields in the preparation plant resulted in our clean coal production costs being considerably higher in 2002 than they were in 2001. We believe that in 2003, our operational performance will revert back to more normal levels as we move back into the interior of the coal resource.

Also in 2002, senior staff at the Quinsam mine actively participated in a task force working to improve the regulations impacting mining activities in British Columbia. Quinsam's participation in this task force will not only serve to enhance our operations in the coming years, but I also believe that this invitation was an indication of the high regard that the regulators hold for the expertise of our operations staff.

Exploration

In 2002 our lease on the T'Sable River property expired. We were not able to negotiate an extension with the resource owner because the owner intends to first pursue exploration of the coal bed methane potential in a portion of its coal resource. Because we were unsuccessful in renegotiating the option, we believed it to be fiscally prudent to write off the investment on our books relating to the past exploration undertaken on the T'Sable River property. However, we have been assured that in the future, the owners of the T'Sable River property will once again consider optioning it to companies which desire to develop the coal resource. Given our long history of exploration on this property and the significant work effort we have put into it over the years, we believe we are in an excellent position to renew the option if and when it becomes available.

A second initiative relates to the exploration for certain industrial mineral properties on Vancouver Island. These minerals include those which Quinsam consumes in the production of coal, as well as minerals necessary for the planned power project. While these efforts are in a preliminary stage, the results to date have been encouraging. A local company has received bulk samples from one deposit for testing.

Environment

The Quinsam Coal Mine remains in compliance with all material environmental regulations. The staff of Quinsam works closely with the authorities mandated to review its compliance and meets with them at least annually.

Safety

Regrettably the perfect safety record Quinsam attained in 2000 and 2001 came to an end in 2002. An employee fell from a ladder and dislocated his shoulder resulting in our first and only lost time accident in three years. Not withstanding this incident we remain very proud of our safety performance. The management and employees of Quinsam will continue to place a high priority on safety training and our objective of completing each and every year accident free. In early 2003, the Quinsam Mine was awarded, for the fourth consecutive year, the B.C. Small Underground Mine Safety Award. This achievement is notable for its consistency.

Coal Acquisitions and Consulting Services

Management and the Board of Directors of Hillsborough are committed to sustained growth in areas in which we have expertise. As I write this, Quinsam remains the only underground coal mine in Canada, and our expertise in underground mining techniques is much sought after. Late in 2001, we commenced a relationship with a group of South American coal mines which culminated this year in the provision to them of consulting services as well as the sale of some of surplus mining equipment and related parts.

As well, we are actively investigating Canadian coal mining opportunities with a view to either providing contracting services or even acquisitions where advantageous.

Power Generation

There is a growing shortfall of electricity supply to consumers on Vancouver Island. Only approximately 30% of the Island's power requirements are generated on the Island, with the balance coming by way of several aging submarine electrical cables from the mainland, as well as a gas pipeline. For a number of years now we have been looking at economical and environmentally friendly ways of reducing our refuse from the coal washing process. These "fines" are stored in a tailings dam. Because of their excellent heating value, these fines, supplemented with our regular coal, could be burned to operate a power generating station and the power generated from this process would be sold into the Vancouver Island grid. Permitting and power sales activities for a 50 to 60 megawatt power generating station, to be located at the Quinsam Mine, are now underway. These activities are expected to continue into 2004.

Coal Bed Methane

We continue to press on with our initiatives to explore the potential for developing coal bed methane gas within our freehold coal rights. However, the title to coal bed methane in British Columbia remains a dispute between the Government of British Columbia and the freehold owners of coal like Quinsam. In its spring session, the Government of British Columbia introduced the Coal Bed Gas Act. This legislation vests title of coal bed methane to the owner of the natural gas rights, which in our case is mainly the Government of British Columbia. This act was introduced in an effort to resolve the uncertainty of title pertaining to coal bed methane. The full impact of this legislation is unclear but the Government

has indicated a willingness to work with the freehold coal owners, including Quinsam, to resolve the outstanding title conflicts. We will continue to aggressively defend our belief that Quinsam is the rightful owner of coal bed methane in its freehold coal deposits and we are currently in discussions with the Ministry of Energy and Mines to resolve these conflicts.

Looking Forward

As I write this letter, approximately 70% of our planned production in 2003 is committed under contract. We are in the midst of a number of initiatives, all in our domestic market, which could increase the return on our planned production and increase sales volumes. If we are successful in our efforts, the mine may have to increase production to meet the increased demand. If such a production expansion were to prove necessary, we are confident that it can be done with our existing equipment fleet, and with only a nominal increase in the work force. A part of this increase in sales may be to other pulp and paper mills following the highly successful use of coal by a pulp and paper mill located on Vancouver Island.

Acknowledgements

In conclusion, I would like to thank all of our shareholders for remaining supportive of our efforts to grow your company. We believe that in 2003, we will accomplish a number of the strategic objectives identified in 2002. I would also like to express my appreciation to our customers who have remained loyal to us in the past year. Finally, I would like to thank our employees for their dedication and unwavering efforts in a year that has not been without its challenges.

Respectfully Yours,

David Slater
President and CEO

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with and is qualified by the audited consolidated financial statements and accompanying notes of Hillsborough Resources Limited ("the Company") which have been prepared in accordance with generally accepted accounting principles in Canada.

The results for 2001 have been restated to reflect the change in the Company's revenue recognition policy which became effective January 1, 2002. All currency in this discussion is in Canadian dollars.

Results of Operations

In 2002 the Company, produced 519,396 tonnes of raw coal compared with 474,327 tonnes produced in 2001. This 9.5% increase in production was accomplished to ensure that adequate clean coal was available to meet an increase in coal sales. The sales increase was achieved because the company sold a significant volume of coal into the international spot market in 2002 as compared to 2001.

Clean coal production in 2002 was 341,432 tonnes implying a yield of 65.7% from the preparation plant. In 2001, clean coal production was 314,483 tonnes with a yield of 66.3% from the preparation plant. Overall yields in 2002 and 2001 were marginally below historical averages because of a higher percentage of ash in the raw coal due to the quality of the coal seams being mined. Operations staff anticipates that in 2003 yields will rise slightly over those attained in the past two years as mining operations revert back into the interior of the coal seam where the coal quality is superior.

In 2002 the cost per tonne of clean coal sold was $39.57 versus $34.89 in 2001. This 13.4% increase in coal production costs was due to the increased transportation costs arising from the increased sales into the spot market and higher operating costs at the mine. The year over year increase in costs was a result of higher mining, transportation, and processing costs in 2002 as compared to 2001.

Earnings and Financial Performance

In 2002, Hillsborough sold 395,619 tonnes of coal versus sales of 226,413 tonnes in 2001. The 75% increase in sales volume was due to an increase in sales in the export market combined with small increases in sales volumes to domestic customers.

The average realized price of coal for 2002 was $45.47 per tonne versus $47.08 per tonne in 2001. The decline in realized price from between 2002 and 2001 was because in 2002 the Company sold a higher percentage of its sales into the lower realization international spot market.

Income from Coal Operations in 2002 totaled $2.3 million versus $2.8 million in 2001. The decline in Income from Coal Operations was a result of a lower average price realized and higher costs as previously discussed.

General and Administration costs of $1,567,144 in 2002 increased by $299,196 (23.6%) over the amount expended in 2001. This increase in costs was due to higher costs of operating a public company and the Company hired one new additional senior executive. Depreciation, depletion and amortization costs in 2002 of $683,713 were 8.5% over those same costs for the year earlier. This increase was due

to the increase in the level of production as the Company employs the unit of production method to account for depreciation, depletion and amortization.

In 2002, there were no financing costs as the Company did not raise any funds in the public market, whereas in 2001, there were a number of financings which accounted for those costs in that year. Interest costs in 2002 fell by $133,803 on a year over year basis because, in 2001, the company repaid the convertible debenture and incurred interest expense on the debenture until May. In 2002, the Company did not incur any profit sharing payments to employees as stipulated in the collective bargaining agreement. In 2001, $56,129 was paid pursuant to the profit sharing arrangement. The costs for creditor arrangements in 2002 related primarily to ongoing administration payments to the court appointed Monitor and some minor legal expenses. In 2001, the company incurred significant legal and accounting costs that related to the creditor protection filing of the previous year.

Other Income rose substantially in 2002 as compared to 2001. In 2002, total Other Income was $552,251 compared to only $70,294 in 2001. Other Income in 2002 included $533,399 from the gain on sale of parts and equipment offset by a $278,083 reduction in the carrying value of the base pad coal inventory. In 2001, assets sales resulted in gains of $67,597 which was offset by asset write downs of $79,412. Foreign exchange gains and interest income in 2002 totaled $228,907 versus $156,058 in the prior year. Also in 2001, the Company wrote down the carrying value of its marketable securities by $196,463. There was no adjustment to these marketable securities in 2002. Miscellaneous Other Income in 2002 was $68,028 compared with $122,514 in 2001. These items are unique events which are not expected to occur again.

In 2002, the Company was unable to renew its option on the T'Sable River coal property and as a result its investment of $731, 318 was written off. This amount represented the Company's entire remaining investment in this property. The Company has actively explored the T'Sable River coal property since 1996. In 2002, Hillsborough expended $62,000 (2001–$181,700) exploring this property. These expenditures were capitalized in accordance with generally accepted accounting principles and they were included in the write off taken in the fourth quarter. As at December 31, 2002, the Company had approximately $318,000 capitalized respecting the power plant investigations.

Liquidity and Capital Resources

As at December 31, 2002, the Company had cash on hand of $3.2 million compared to $1.85 million as at December 31, 2001. The cash was generated mostly from the reduction in coal inventories that occurred with the increase in the volume of coal sales. Also, because of the higher level of sales in 2002 over 2001 and the extended payment terms relating to equipment sales, accounts receivable increased by $0.46 million. Inventories declined by $1.85 million between December 31, 2001 and December 31, 2002. Because the Company sells coal into the spot market it will be required to build inventories to meet these shipments and once the shipment is made there will be a corresponding reduction in the value of coal inventories. Between December 31, 2001 and December 31, 2002 current liabilities increased by $0.5 million, largely in response to the increased level of production. During 2002,

working capital decreased by $588,000 as the Company eliminated its long term debt and any payments possibly owing to certain creditors were reclassified from a long term liability to a current liability.

In 2002 cash flow from operating activities was $2.6 million compared to negative $3.4 million in 2001. The reason for the increase in cash flow from operating activities between the two twelve month periods was that in 2001 Hillsborough was building coal inventories to meet a number of contractual shipments into the international spot market planned for 2002.

Net capital spending in 2002 on replacement capital was essentially the same as the prior year at $1.01 million and $1.19 million, respectively. In 2002, Hillsborough acquired some mining leases and related equipment and issued 682,680 common shares valued at $395,954. These common shares are currently being held in escrow and will be released only if Hillsborough achieves certain agreed upon objectives.

Apart from the issuance of shares for the acquisition of the mining lease, Hillsborough had minimal other financing activities, excepting scheduled capital lease repayments. Additionally, in 2002 the Company repurchased and cancelled common shares with a market value of $13,243. As at December 31, 2002 Hillsborough had no long term debt remaining. In 2001 Hillsborough received proceeds of $9.5 million from the sale of common equity. Of this amount, Hillsborough repaid $3.7 million of debt, including convertible debentures. The remainder was used to reduce trade payables and for other general working capital requirements.

Safety and the Environment

In April 2003, the Quinsam Coal Corporation was awarded the Small Underground Mine Safety Award in British Columbia for the fourth consecutive year. This is a commendable achievement, once again. The Quinsam Mine remains in compliance with all material environmental regulations. The mine site staff continues to work closely with the authorities mandated to review its compliance activities and meets with them at least annually.

Outlook

The Company anticipates that domestic coal sales volumes in 2003 may increase modestly over the sales in 2002. Realized prices should remain at levels consistent with those realized in 2002. Because most of the Company's sales are made on a contractual basis, the recent increases in oil and natural gas prices are not expected to immediately translate into higher coal prices, although it is possible that the tonnage of coal sold may increase. During the fourth quarter of 2002, the Company made its first commercial sales to a local pulp and paper company. The company believes that it may successfully convince other pulp and paper companies to burn coal because of its favourable economics and burn characteristics compared to other fuels in this application. Hillsborough has also conducted successful trial burns with two potential customers on the west coast of North America. The Company is optimistic that one or both of these operations will enter into long term contracts to buy the Company's coal.

Capital spending in 2003 is expected to decline to approximately $0.5 million in 2003 compared to cash expenditures of $1.4 million in 2002.

In October, 2003 the obligations of Quinsam Coal Corporation to certain unsecured creditors arising from an order from the Supreme Court of British Columbia pursuant to the Companies Creditor Arrangement Act will expire. Quinsam has remaining in its financial statements, liabilities totaling $727,557 relating to this order. These amounts are to be repaid during the life of the court order if Quinsam generates a predetermined level of cash flow. It is unlikely that this predetermined level of cash flow will be attained and accordingly the obligation to pay these amounts will expire. At the time these liabilities are written off, Quinsam will realize a benefit to earnings of the amount of the remaining obligation.

The Company will continue to pursue the coal fired power plant project located on Vancouver Island; however, it can give no assurance that these efforts will be successful. Also, the Company anticipates a resolution to the title conflict over coal bed methane by mid 2003. If a resolution to the title conflict is attained, the company believes that the first exploration drilling activities will commence before year end, assuming that all environmental permits are received in an orderly manner.

HILLSBOROUGH RESOURCES LIMITED
Consolidated Financial Statements

December 31, 2002 and 2001

Together with Management Responsibility Letter and Auditors' Report

Management's Responsibility for Financial Reporting

To the Shareholders of Hillsborough Resources Limited:

The accompanying consolidated financial statements of the Company were prepared by management in accordance with accounting principles generally accepted in Canada, and within the framework of the summary of significant accounting policies in the notes to these financial statements. Management is responsible for all information in the annual report. All financial and operating data in the annual report is consistent, where appropriate, with that contained in the consolidated financial statements.

A system of accounting and control is maintained in order to provide reasonable assurance that the assets are safeguarded and that transactions are properly recorded and executed in accordance with management's authorization. The system includes established policies and procedures, the selection and training of qualified persons as is reasonably possible, and an organization providing for the appropriate delegation of authority and segregation of responsibilities as is appropriate for a company of the size of Hillsborough.

The Board of Directors discharges its responsibilities for the consolidated financial statements primarily through the activities of its Audit Committee composed of three independent directors. This Committee meets with management and the company's independent auditors to assure that it is performing its responsibility to maintain financial controls and systems and to approve all financial information released to the public. The Audit Committee also meets with the independent auditors to discuss the scope and the results of the audit and the audit report prior to submitting the financial statements to the Board of Directors for approval.

The consolidated financial statements for 2002 have been audited on behalf of the shareholders by the Company's independent auditors, PricewaterhouseCoopers LLP, in accordance with Canadian generally accepted auditing standards. The auditors report outlines the scope of their audit and their opinion on the consolidated financial statements.

D.J. Slater,
President and C.E.O

Scott M. Brunsdon,
Vice President Finance
and Corporate Development

February 28, 2003

To the Shareholders of Hillsborough Resources Limited:

We have audited the consolidated balance sheet of HILLSBOROUGH RESOURCES LIMITED as at December 31, 2002 and the consolidated statements of operations and retained earnings (deficit) and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at December 31, 2001 and for the year then ended were audited by other auditors who expressed an opinion without reservation on these statements in their report dated March 8, 2002. Note 16 to those financial statements presented the impact on the financial statements as at and for the year ended December 31, 2001 of retroactively adopting a new policy for revenue recognition effective January 1, 2002. The comparative financial statements as at and for the year ending December 31, 2001 have been amended to incorporate the information in this note. In our opinion, such adjustments have been properly applied.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Vancouver, British Columbia

February 28, 2003

CONSOLIDATED BALANCE SHEETS
As at December 31

	2002	(restated) 2001
	$	$
ASSETS		
Current Assets		
Cash and cash equivalents	3,177,569	1,851,084
Marketable securities	71,441	71,441
Receivables	1,407,659	952,928
Inventories (Note 3)	3,751,636	5,600,770
Prepaid expenses	131,315	158,308
Asset held for sale	118,492	112,387
	8,658,112	**8,746,918**
Property, Plant and Equipment (Note 4)	**6,704,586**	**6,473,251**
Reclamation Deposits and Deferred Charges (Note 5)	**1,770,366**	**1,733,274**
	17,133,064	**16,953,443**
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities (Note 7)	2,765,533	1,868,831
Current portion of loans and lease obligations (Note 6)	–	233,776
Income and resource taxes payable	17,516	180,950
	2,783,049	**2,283,557**
Other Liabilities (Note 7)	**300,094**	**810,401**
	3,083,143	**3,093,958**
COMMITMENTS (Note 13)	–	–
SHAREHOLDERS' EQUITY		
Capital stock (Note 9)	12,205,483	11,864,942
Warrants (Note 9)	200,000	200,000
Contributed surplus	1,755,153	1,712,983
Retained earnings (deficit)	(110,715)	81,560
	14,049,921	**13,859,485**
	17,133,064	**16,953,443**

Approved by the Directors:

Winston D. Stothert, *Director*

David J. Slater, *Director*

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS (DEFICIT) For the years ended December 31	2002	(restated) 2001
	$	$
COAL REVENUES (Note 2 and 16)	**17,987,444**	**10,659,328**
Coal Production Expenses	15,653,661	7,899,794
INCOME FROM COAL OPERATIONS	**2,333,783**	**2,759,534**
EXPENSES (INCOME)		
General and administrative	1,567,144	1,267,948
Depreciation, depletion and amortization	683,713	630,148
Financing costs (Note 9)	–	190,000
Interest	35,191	168,994
Employee profit sharing	–	56,129
Corporate restructuring	13,065	32,479
Creditor arrangements	5,548	12,384
Write-down of mineral properties (Note 4)	731,318	–
Other income, net (Note10)	(552,251)	(70,294)
	2,483,728	**2,287,788**
Income (Loss) Before Provision for Taxes	(149,945)	471,746
Provision for Taxes (Note 11)	42,330	158,608
NET INCOME (LOSS)	**(192,275)**	**313,138**
Retained Earnings (Deficit), beginning of year (Note16)	81,560	(36,104,075)
Deficit Reduced by Capital Stock Reduction (Note 9)	–	35,872,497
RETAINED EARNINGS (DEFICIT), end of year	**(110,715)**	**81,560**
Earnings (Loss) per share (Note 12 and 16)		
Basic	**(0.01)**	**0.02**
Diluted	–	**0.01**

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS **For the years ended December 31**	**2002**	**(restated)** **2001**
	$	**$**
OPERATING ACTIVITIES		
Net income (loss)	(192,275)	313,138
Items not affecting cash		
• Depreciation, depletion and amortization	683,713	630,148
• Amortization of deferred financing costs	–	190,000
• Write-down of mineral properties	731,318	–
• Write-down of marketable securities	–	196,463
• Write-down of base pad inventories	278,083	–
• Gain on disposal of capital assets, net	(269,293)	(59,022)
• Gain on sale of parts	(264,106)	–
• Reclamation provision	17,141	8,537
	984,581	**1,279,264**
Changes in non-cash operating accounts (Note 15)	**1,602,991**	**(4,656,030)**
	2,587,572	**(3,376,766)**
INVESTING ACTIVITIES (Note 15)		
Capital asset additions	(1,423,965)	(1,281,705)
Change in reclamation deposits and deferred charges	(39,604)	–
Proceeds from disposal of capital assets	449,501	92,500
	(1,014,068)	**(1,189,205)**
FINANCING ACTIVITIES (Note 15)		
Loans and lease obligation payments	(233,776)	(3,436,968)
Shares issued for exercised stock options	–	25,800
Special warrants issued, net of issue costs	–	9,519,408
Shares repurchased and cancelled	(13,243)	–
Repayment of convertible debentures (Note 8)	–	(300,000)
	(247,019)	**5,808,240**
INCREASE IN CASH AND CASH EQUIVALENTS	**1,326,485**	**1,242,269**
Cash and Cash Equivalents, beginning of year	1,851,084	608,815
CASH AND CASH EQUIVALENTS, end of year	**3,177,569**	**1,851,084**
Cash flows include the following elements:		
Income and resource taxes paid	**218,000**	**137,000**
Interest paid		
In respect of the current year	35,000	169,000
In respect of prior years	–	582,000
	35,000	**751,000**

The accompanying notes are an integral part of these consolidated financial statements.

1. BASIS OF PRESENTATION

a. Nature of Operations

These consolidated financial statements include the accounts of Hillsborough Resources Limited (Hillsborough), its wholly-owned subsidiaries, Quinsam Coal Corporation (Quinsam), T'Sable River Coal Corporation (T'Sable), D and R Resources Inc. and G H Fuels Limited, and its wholly-owned inactive subsidiaries, CBL Acquisition Corp., Mine Services International Inc., Can-Am Airlines Inc. and American Dorset Inc. (collectively referred to as the Company).The Company is engaged in the exploration for, the development of and the operation of coal properties, primarily targeted to the thermal or industrial coal markets. Investigations are underway toward developing coal bed methane resources and also to develop a coal fired electricity plant captive to its owned coal resources.

b. Basis of Presentation

The consolidated financial statements are presented in accordance with generally accepted accounting principles applicable in Canada as typically applied in the mining and exploration industry. These statements include the accounts of all of the Company's subsidiaries and all inter-company transactions have been eliminated.

The Canadian dollar is the Company's reporting currency and the currency of measurement for all financial transactions reported in these financial statements.

c. Financial and Operational Restructuring

On May 14, 1999, Quinsam Coal Corporation ("Quinsam") obtained an order from the Supreme Court of British Columbia pursuant to the Companies Creditors Arrangement Act (CCAA) seeking protection from its creditors. On May 20, 1999, Hillsborough, as a consequence of Quinsam filing for protection, also obtained an order from the Supreme Court of British Columbia pursuant to the CCAA. The orders were sought so that Quinsam could continue operating its mine while it negotiated with its senior lenders and other creditors to restructure its debts.

Quinsam initially submitted a Plan of Arrangement (the Plan) which provided for its financial and operational restructuring; however, the Plan was subject to a number of conditions. The Plan was approved at a meeting of creditors on March 14, 2000, but the Plan, in its original form, could not be concluded. Certain amendments to the Plan were proposed and a further Plan (the Revised Plan) was presented and approved by the Quinsam creditors at a general meeting held on September 21, 2000. The Revised Plan allows the Quinsam creditors to receive up to 25 percent of the free cash flow of Quinsam for a period of three years from September 1, 2000, to a maximum of 20 percent of proven claims.

By order of the Supreme Court of British Columbia, a special meeting of the shareholders of Hillsborough was held on September 21, 2000 to vote on a financing proposal made by a private

company. The proposal was approved and the key terms of the proposal provided for the following:

(a) a secured loan to Quinsam of approximately $3.1 million, repayable over five years, sufficient to enable full payment to Quinsam's secured creditors;

(b) the issuance to this private company of 4,000,000 five-year warrants to purchase common shares of Hillsborough at an exercise price of $0.36 per share; and

(c) repayment by Hillsborough of $4.0 million on account of a $5.0 million convertible debenture due to a private company and the further payment, on or before October 31, 2000, of the balance of approximately $1.0 million (see Note 8).

On October 5, 2000, the Supreme Court of British Columbia approved the Revised Plan in respect of Quinsam and, subject to its implementation, directed that the outstanding protective orders under the CCAA in respect of Quinsam and Hillsborough be lifted.

The transactions necessary to implement the Revised Plan were implemented on October 6, 2000, including the following:

(a) the acquisition by a private company of the $3.0 million term loan owing by Quinsam to another private company, and the execution of amendments to the loan agreement extending the maturity date;

(b) the issuance to a private company of 4,000,000 five-year warrants to purchase common shares of Hillsborough at an exercise price of $0.36 per share; and

(c) the payment by Hillsborough to a private company of $4.0 million on account of the amount due under the $5.0 million convertible debenture and the execution of an agreement amending the conversion terms.

As described above, the Revised Plan allows the unsecured creditors of Quinsam to receive up to 25 percent of the free cash flow of Quinsam for a period of three years from September 1, 2000, to a maximum of 20 percent of proven claims.

Accordingly, in 2000, Quinsam wrote down its liabilities to unsecured creditors, to the maximum of 20 percent of proven claims, in the amount of $4.7 million and has recognized a gain on settlement of liabilities on the statement of operations (see Note 7 for unsecured creditors amounts at December 31, 2002 and 2001).

In 1999, assets and liabilities were written down in the amount of $27.1 million, but no write-downs were made in respect of Quinsam's liabilities to unsecured creditors because the creditors' claims had not been fully settled in that year. The components of the $27.1 million write-down in 1999 are summarized below:

	Millions $
Quinsam	
Capital assets, working capital and investments	31.3
Due to Marubeni Coal Canada Ltd. (Marubeni)	(7.6)
Hillsborough	
Capital assets of Hillsborough and T'Sable	3.4
	27.1

Since the protective orders under the CCAA in respect of Quinsam and Hillsborough were lifted on October 5, 2000, the Company has been operating under the terms of the Revised Plan. Management's plans are to continue operations in the normal course of business under the terms of the financial and operational restructuring described above.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Use of Estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts and the valuation of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, the future income tax assets or liabilities, future environmental obligations and site restoration costs and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates made by management.

b) Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, demand deposits, and guaranteed investment certificates with maturities at the date of purchase of three months or less.

c) Marketable Securities

Marketable securities are recorded at the lower of cost and market value.

d) Coal Inventory

Raw coal inventory and clean coal inventory are valued at the lower of average cost and net realizable value.

e) Supplies Inventory

Supplies inventory is recorded at the lower of average cost and net realizable value.

f) Property, Plant and Equipment

Quinsam Coal Mine

Buildings, plant and equipment are recorded at cost less accumulated depreciation, depletion and write-downs. Depreciation for buildings and plant is provided on the straight-line method based on the estimated useful lives of the assets according to the current mine plan. Depreciation for equipment is provided on the declining-balance method based on the estimated useful lives of the assets. The depreciation rates range from 5 percent to 50 percent. Depletion of mine development costs is provided over the estimated life of the mine on a units of production basis using the current mine plan.

Exploration mineral properties

Investments in exploration mineral properties are recorded at cost. In those cases where exploration activities are conducted jointly with others, only the Company's proportionate interest in the related mineral project is included in the financial statements. All costs of acquiring mineral properties are capitalized and related costs of financing, including interest, and exploration and development costs are deferred on a project basis. When a property is put into commercial production, the related investment is amortized on the unit-of-production method. If the carrying value exceeds the anticipated net recoverable amount, the excess is charged to earnings.

If a project is abandoned, the investment is charged to earnings. The recovery of the carrying amount of mineral properties in the exploration stage is dependent upon the future commercial success of the related property or the proceeds from its disposition.

Contracting and Administrative assets

Contracting and Administrative assets are recorded at cost. Depreciation is provided using the declining-balance method over the estimated useful lives of the assets. The rates applied to the principal classes of depreciable assets are as follows:

Buildings	5%
Furniture and fixtures	20%
Equipment	30% to 50%

g) Reclamation Deposits and Deferred Charges

The deposits primarily consist of funds deposited with financial institutions as security for agreements required for future environmental obligations, mining permits or other business related activities.

h) Revenue Recognition

Coal revenue is recognized when a sale of coal is contractually entered into and risk to and title of the coal has passed to the buyer. The Company adopted this policy effective January 1, 2002. The financial statements for 2001 have been restated to reflect this change in policy. See Note 16 for an explanation of the effect of this change.

i) Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Temporary differences arising from the difference between the tax basis of an asset and a liability and its carrying amount on the balance sheet are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to be in effect in the periods that the temporary differences are expected to be settled or realized. A valuation allowance is provided to the extent that it is more likely than not that those future income tax assets will not be realized. The effect of a change in income tax rates on future income tax assets and liabilities is recognized in income in the period that the change occurs.

j) Foreign Currency Translation

Sales and trade transactions denominated in foreign currencies are recorded in Canadian dollars at the exchange rate prevailing at the time of the transaction. Foreign exchange gains and losses are treated as a component of the related transaction and are included in earnings or capitalized accordingly.

Monetary assets and liabilities denominated in foreign currencies are converted into Canadian dollars at the exchange rate prevailing at the balance sheet date.

k) Reclamation and Site Restoration Costs

Provisions for estimated reclamation, site restoration, and other closure costs are charged against income using the unit-of-production method based upon the existing mine plan commencing when a reasonably accurate estimate of the cost can be made. Ongoing reclamation activities are charged to earnings as incurred unless previously accrued.

l) Financial Instruments

The Company's financial instruments consist of guaranteed investment certificates, marketable securities, receivables, accounts payable, loans and lease obligations, convertible debentures and other liabilities. Management estimates that the fair values of these financial instruments approximate their carrying values, unless otherwise noted.

m) Hedging Transactions

The Company does not hedge the price of its coal production. Some coal contracts are denominated in currency other than the Canadian dollar. The Company may enter into a foreign exchange

contract to fix the exchange rate on these anticipated sales. If the sale does not materialize on the date that the foreign exchange contract matures the gain or loss is reported in Other Income.

n) Earnings per share

Earnings per share are calculated using the weighted average number of shares outstanding. The Treasury Stock method is used to calculate diluted earnings per share.

o) Comparative Figures

Certain prior year amounts have been reclassified to conform to the current year presentation.

3. INVENTORIES

	2002	2001
	$	$
Coal	3,196,668	5,106,037
Supplies	554,968	494,733
	3,751,636	**5,600,770**

4. PROPERTY, PLANT and EQUIPMENT

	2002	2001
	$	$
Producing mining properties		
Quinsam Coal Mine		
• Land, buildings, plant and equipment	5,282,366	4,808,818
• Exploration, development and other	678,130	470,122
	5,960,496	**5,278,940**
Exploration mineral properties	**344,702**	**668,479**
Other	**329,253**	**76,415**
Contracting and administrative assets		
• Equipment	3,201,414	2,953,574
• Furniture and fixtures	163,482	157,437
	3,364,896	**3,111,011**
	9,999,347	**9,134,845**
Less accumulated depreciation, depletion and amortization		
• Producing mining properties	897,248	551,586
• Contracting and administrative assets	2,397,513	2,110,008
	3,294,761	**2,661,594**
	6,704,586	**6,473,251**

Exploration Mineral Properties

The Company was party to an Exploration Agreement with a third party which provided the Company with an option to acquire coal rights over an area of land known as the T'Sable River property. This agreement expired in 2002 and the Company was unable to negotiate an extension of the lease. As a result the expenditures previously capitalized were written off in the fourth quarter of 2002. The amount charged to earnings in 2002 was $731,318 (2001–zero).

In 2002, the Company acquired D and R Resources Inc. by issuing 682,680 common shares which remain in escrow pending the satisfaction of certain conditions. The allocation of the assets owned by D and R Resources Inc. is more fully described in Note 15.

Equipment under Capital Lease

At December 31, 2002, there was no equipment under a capital lease. In 2001 there was equipment with a cost of $620,660 and accumulated amortization of $473,897 under capital lease.

5. RECLAMATION DEPOSITS AND DEFERRED CHARGES

	2002	2001
	$	$
Guaranteed investment certificates	1,653,000	1,637,500
Other	117,366	95,774
	1,770,366	**1,733,274**

The guaranteed investment certificates have been lodged as security for mining permits and other obligations.

6. LOANS AND LEASE OBLIGATIONS

	2002	2001
	$	$
Obligations under capital leases of equipment	–	233,776
	–	233,776
Current portion of loans and lease obligations	–	233,776

7. OTHER LIABILITIES

	2002	2001
	$	$
Unsecured creditors	–	417,542
User fees on coal facilities	27,476	137,383
Reclamation and site restoration	272,618	255,476
	300,094	**810,401**

Unsecured creditors

As at December 31, 2002, the Company has $727,557 (2001–$727,557) recorded as liabilities in respect of Quinsam's unsecured creditor claims resulting from the CCAA order. This entire amount (2001–$310,015) is presented in accounts payable on the balance sheet. In 2001 $417,542 was presented as a long-term liability. This obligation expires in 2003 and any amounts owing, but not paid, will be written off and a corresponding gain will be recognized.

User fees on coal facilities

As at December 31, 2002, the Company has $137,383 (2001–$247,289) recorded as liabilities in respect of usage fees on coal facilities. Of this amount, $109,907 (2001–$109,906) is presented in accounts payable on the balance sheet and the remaining $27,476 (2001–$137,383) is presented as a long-term liability.

8. CONVERTIBLE DEBENTURES

On February 6, 1998, the Company issued and sold, by way of private placement, $5.0 million of convertible unsecured subordinated debentures to a private company. The debentures had an interest rate of 6 percent per annum, payable semi-annually commencing on December 31, 1998, and were convertible at any time at the option of the holder into that number of common shares of the Company obtained by dividing the principal amount of the debentures to be converted by $1.15. Except in limited circumstances, the debentures were not redeemable until December 31, 1999. After such date, the debentures were redeemable by the Company at the principal amount plus accrued interest subject to certain conditions. Management determined at issuance that no material value was attributable to the equity component of these convertible debentures; accordingly, the full amount of the convertible debentures was presented as a liability on the balance sheet.

In 2001, the Company paid the remaining balance of $300,000 to fully retire the convertible debentures. In 2001 $575,063 was paid in accrued interest owing on these debentures. In 2001, the interest expense on these debentures was $5,959.

9. CAPITAL STOCK

	Number of Shares	Amount
		$
Authorized		
Unlimited number of common shares (without par value)		
Issued and outstanding		
Balance, December 31, 2000	17,772,868	38,192,231
Options exercised for cash	260,000	25,800
Exercise of special warrants	11,000,000	9,519,408
Deficit Reduction	–	(35,872,497)
Balance, December 31, 2001	29,032,868	11,864,942
Issued for acquisition, held in escrow	682,680	395,954
Shares repurchased and cancelled	(33,820)	(55,413)
Balance, December 31, 2002	**29,681,728**	**12,205,483**

On August 20, 2002 the Company initiated a normal course issuer bid which will continue until August 19, 2003 unless terminated sooner by the Company. The purchase of common shares must be made at the market price through the facilities of the Toronto Stock Exchange and all shares purchased pursuant to this normal course issuer bid must be cancelled. In 2002 the Company purchased and cancelled 33,820 common shares at a cost of $13,243.The Company may purchase a maximum of 500,000 common shares pursuant to this issuer bid.

A Director and Employee Incentive Stock Option and Share Compensation Plan (the "Plan"), approved by the shareholders of the Company, allows the Compensation Committee of the Board of Directors, to make grants of options and stock appreciation rights to directors and key employees to purchase common shares of the Company. Under the Plan the aggregate number of common shares reserved for issuance at the date of grant of any option does not exceed 3.4 million common shares. The option price will be determined by the Board of Directors at the time an option is granted, however, the exercise price of the option will not be less than the market price of the common shares on the date of the grant. The term of the award shall be for ten years from the date of the grant and all grants vest either immediately or within 24 months. There have been no grants of stock appreciation rights as at December 31, 2002.

	2002		2001	
	Options	**Weighted Average Exercise Price**	**Options**	**Weighted Average Exercise Price**
		$		$
Options outstanding, beginning of year	1,680,500	0.39	1,355,500	0.33
Issued	407,500	0.53	585,000	0.41
Exercised	–		(260,000)	0.10
Forfeited	(90,000)	0.38	–	–
Expired	–	–	–	–
Options outstanding, end of year	**1,998,000**	**0.42**	**1,680,500**	**0.39**

At December 31, 2002, the Company has 1,998,000 (2001–1,680,500) options outstanding at the following exercise prices:

Exercise Price	Number Granted	Expiry Date	Options Outstanding	Number Vested	Weighted Ave. Price
$0.00 – $0.09	525,000	2009	200,000	200,000	$0.07
$0.10 – $0.19	776,500	2010	400,000	400,000	$0.10
$0.20 – $0.29	–	–		–	–
$0.30 – $0.39	730,000	2011	630,000	560,000	$0.36
$0.40 – $0.49	–	–		–	–
$0.50 – $0.59	417,500	2011	417,500	265,000	$0.50
$0.60 – $0.69	20,000	2012	20,000	20,000	$0.60
$0.70 – $0.79	–	–	–	–	–
$0.80 – $0.89	–	–	–	–	–
$0.90 – $0.99	25,000	2011	25,000	15,000	$0.96
$1.00	391,000	2008	305,500	305,500	$1.00
	2,885,000		**1,998,000**	**1,765,500**	

In 2002, the Company adopted the CICA standard "Accounting for Stock-based Compensation and Other Stock-Based Payments". As the equity awards granted by the company consisted solely of options, the company has chosen to disclose the fair market value estimate of these options. The disclosure includes the estimated fair market value of 100% of the options granted. For 2002,

the estimated fair market value of options granted to employees was $109,457. To estimate this fair market value of the options granted, the Black-Scholes option valuation model was used. The following assumptions were employed to estimate fair market value:

a) Exercise price:	market at the time of the grant
b) Average Life of Option:	3.28 years, based upon historical evidence
c) Estimated Volatility:	67%
d) Interest Rate:	5.15% to 5.56% depending upon grant date
e) Dividends:	none

If the company had charged the fair value of stock options to earnings the loss would have increased from $192,275 to $301,852. The loss per share does not change as a result of this.

Special warrants

On May 11, 2001, the Company completed a private placement of 10,376,738 special warrants at a subscription price of $0.95 per special warrant, yielding gross proceeds of $9,857,901. The agents on this offering received a cash commission of 5.5 percent of the gross proceeds, plus 200,000 special broker's warrants convertible for no additional consideration into broker's warrants entitling the agents to purchase 200,000 common shares at $0.98 per share until May 11, 2002.

On June 5, 2001, the Company completed a private placement of 623,262 special warrants at a subscription price of $0.95 per special warrant, yielding gross proceeds of $592,099. The agents on this offering received a cash commission of 5.5 percent of the gross proceeds.

Each of the special warrants described above entitled the holder to acquire, at no additional cost, one common share of the Company during a specified period. On September 10, 2001, 11,000,000 common shares were issued pursuant to these special warrants.

The agent commissions and other expenses of $930,592 incurred with respect to the 11,000,000 special warrants were netted against the gross proceeds.

Warrants

At December 31, 2002, the Company has 4,000,000 warrants outstanding to acquire common shares of the Company at $0.36 per share which are exercisable at any time prior to October 6, 2005.

As described in Note 1, these warrants were issued to a private company in conjunction with a term loan provided to Quinsam.

The fair value of these warrants was estimated at $200,000 and was accounted for as a cost of financing. The outstanding balance of $190,000 was charged to earnings in 2001 when the Company repaid the term loan.

Deficit reduction against share capital

On June 20, 2001 at the Company's Annual General Meeting, the shareholders approved a motion to reduce the stated capital of the Company's common shares by $35,872,497, which represents the deficit of the Company at December 31, 2000. Such reduction is effected by decreasing the Company's deficit by the same amount.

10. OTHER INCOME (EXPENSE)

	2002	2001
	$	$
Interest and Foreign Exchange	228,908	207,735
Base Pad Coal Write-down	(278,083)	–
Gain on disposal of assets, net	269,293	59,022
Gain on sale of parts	264,106	–
Write-down of marketable securities	–	(196,463)
Other Miscellaneous	68,027	–
	552,251	**70,294**

11. PROVISION FOR INCOME AND RESOURCE TAXES

	2002	2001
	$	$
Provision for current income and resource taxes	42,330	158,608
Provision for future income taxes	–	–
Provision for income and resource taxes	**42,330**	**158,608**

The provision for (recovery of) income and resource taxes is analyzed in the following table to show the taxes that would be payable by applying statutory tax rates to the Company's pre-tax earnings and the taxes actually provided in the accounts.

December 31, 2002 and 2001

	2002	2001
	$	$
Income before provision for income and resource taxes	(149,945)	471,746
Combined statutory tax rates	**40%**	**45%**
Expected tax provision at statutory rate	(59,978)	212,286
Adjust for tax effect of		
Non-deductible items	(72,087)	(33,424)
Non-taxable portion of capital gains	–	15,000
Utilization of unrecorded income tax assets and loss carryforwards	(624,280)	(503,276)
Resource and large corporation taxes	42,330	158,608
Other items	756,345	309,414
Provision for income and resource taxes	**42,330**	**158,608**

At December 31, 2002, the Company has tax loss carryforwards of approximately $2.7 million of which $0.2 million expires in 2006, $2.1 million expires in 2007, and $0.4 million expires in 2009. In addition, the Company has approximately $41.4 million of deductible temporary differences (includes approximately $11.2 million of resource deductions. of which $0.4 million are successored pools and their value may not be realizable).The Company has taken a full valuation allowance in respect of these amounts; accordingly, no future income tax asset has been recognized in these financial statements.

Temporary differences and tax loss carryforwards that give rise to future income tax assets as at December 31, 2002 and 2001 are described below.

Future income tax assets

	2002	2001
	$	$
Tax loss carryforwards	1,093,302	855,000
Tax values of assets in excess of carrying values	14,471,481	22,050,000
Total future income tax assets	**15,564,783**	**22,905,000**
Valuation allowance	(15,564,783)	(22,905,000)
Future income tax assets	–	–

12. EARNINGS PER SHARE

Earnings (loss) per share have been calculated based on the weighted average number of shares outstanding during the year ending December 31, 2002 of 29,158,125 (2001–21,367,417). The fully diluted loss per share for the year ending December 31, 2002 has not been disclosed as the exercise of options or warrants would be anti-dilutive.

13. COMMITMENTS

(a) During 1996, Quinsam managed the construction of a coal transportation, storage and loading facilities all located at the Middle Point terminal near Campbell River, B.C. These improvements are owned by the British Columbia Transportation Authority (BCTFA) and the BCTFA provided Quinsam with financing of $9.0 million to complete these improvements. Pursuant to a Project User Agreement, Quinsam has agreed to pay for the use of the facilities by way of a monthly usage fee determined by the volume of clean coal transported from the mine site for the period from September 1, 1996 to August 31, 2011.

(b) Quinsam entered into a haulage contract with a company to transport coal from the Quinsam mine site to the storage and loading facility at Middle Point for the period from January 1, 1996 to December 31, 2005.

(c) Under the terms of a Profit Sharing Plan with its employees, Quinsam is obligated to pay 10 percent of its net profits from coal operations during each fiscal year until the expiration of the collective bargaining agreement in April 2003.

As at December 31, 2002 the mark to market value of the Company's foreign exchange contracts was $20,575 (2001–zero).

14. RELATED PARTY TRANSACTIONS

During 2002, the Company paid legal and consulting fees of approximately $322,902 (2001–$130,000) to companies which are related to two directors of the Company.

15. SUPPLEMENTARY CASH FLOW INFORMATION

a) Analysis of Change in Non Cash Working Capital

	2002	2001
	$	$
Marketable Securities	–	22,500
Receivables	(454,731)	(12,815)
Coal inventory	1,631,286	(3,070,910)
Supplies Inventory	(60,235)	(110,717)
Assets held for Sale	253,854	(112,387)
Prepaid Expenses	26,993	94,137
Payables and Accruals	369,258	(1,487,568)
Taxes Payable	(163,434)	21,730
Increase (Decrease)	**1,602,991**	**(4,656,030)**

b) Non Cash Investing and Financing Activities

Issue of Common shares for:	2002	2001
Acquisition of mineral properties	318,520	–
Acquisition of depreciable assets	77,434	–

16. REVENUE RECOGNITION—CHANGE IN ACCOUNTING POLICY

As described in the Summary of Significant Accounting Policies, in 2001, the Company recognized coal revenue upon production when processing was complete and sales contracts existed to deliver the coal. Unbilled revenue was recorded at its estimated net realizable value.

The Company changed its revenue recognition policy effective January 1, 2002. The new policy will recognize revenue from coal sales when legal title to the coal has been transferred to the purchaser.

Canadian generally accepted accounting principles require that a change in accounting policy be applied retroactively. As a result, the financial statements for 2001 and prior were restated to give effect to the new accounting policy for the preparation of its 2002 financial statements. The effect of this change in accounting policy on the 2001 financial statements is described below.

December 31, 2002 and 2001

	Prior Policy	Current Policy
	$	$
Revenue	14,880,499	10,659,328
Net income	775,062	313,138
Unbilled revenue	6,610,806	–
Coal inventory	443,370	5,106,036
Accounts payable and accrued liabilities	3,123,469	1,868,831
Earnings per share	0.04	0.02

The effect of this change in accounting policy on opening retained earnings is as follows:

	2002	2001
	$	$
Retained Earnings (deficit) beginning of year	775,062	(35,872,497)
Adjustment due to adoption of new policy	(693,502)	(231,578)
Retained Earnings (deficit) beginning of year, as restated	**81,560**	**(36,104,075)**

17. CONTINGENCIES

In late 2002, the Company was advised by the Canada Customs and Revenue Agency ("CCRA") that it was being assessed $223,000, which includes interest and penalties, in respect of GST amounts potentially owing. These amounts arose in respect of debts that were forgiven in accordance with the court's ruling that applied to the Company while it was under CCAA protection (Note 1c). The Company, on the advice of its legal counsel, has appealed this assessment and will continue to defend its legal position and its interpretation of the creditors' protection ruling of the court. In January, the Company paid this amount to CCRA to foreclose the possibility of additional interest and penalties being assessed in the event that the Company is not successful in its appeal.

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R. Gordon Marantz, Q.C. (4)(3)

Winston D. Stothert, Chairman (1)(2)

George W. Stuart (1)(2)

David J. Slater

(1) Member of the Audit Committee

(2) Member of the Human Resources & Compensation Committee

(3) Member of the Corporate Governance Committee

(4) Member of the Environmental & Safety Committee

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The Toronto Stock Exchange
TSE stock symbol : HLB

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